



090213

UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FIFTH FLOOR  
803 WEST BROAD STREET  
FALLS CHURCH, VIRGINIA 22046

Mr. M. T. Allen, President  
Government Services, Inc.  
1135 21st Street, N.W.  
Washington, D.C. 20036

MAY 5 1975

Dear Mr. Allen:

As you know we have recently completed our audit of GSI's 1974 financial statements. As in past years, we would again like to bring to your attention observations made during our audit which were not included in our report to the Board of Trustees. The enclosed management summary details these observations and presents suggestions for corrective actions for your consideration. These matters have been discussed with members of your staff and, where appropriate, their views have been incorporated into our comments.

Based on our conversation with you on November 22, 1974, and observations made during our audit, we believe that substantial improvements have been or are being made on most matters discussed in our last management letter. Regarding our comments on the need for an internal audit function, you expressed a preference to use outside firms to review management and operations when the need arises. We continue to believe, for the reasons presented in our letter, that the operations of GSI and particularly the effectiveness of management controls would be strengthened by the initiation of an internal audit function. We suggest that, after a reasonable trial period, the use of outside firms in lieu of a permanent internal audit function be fully evaluated so that you will be assured that effective management controls are being achieved.

We appreciate the courtesies and cooperation given us by your staff. We will be happy to discuss the management summary with you or furnish additional information that might assist in your consideration of our observations.

Sincerely,

*H. L. Krieger*

H. L. Krieger  
Regional Manager

909473

AUDIT OF  
GOVERNMENT SERVICES, INC.  
CALENDAR YEAR 1974  
MANAGEMENT SUMMARY

U.S. GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FALLS CHURCH, VIRGINIA  
APRIL 1975

## C o n t e n t s

	<u>Page</u>
ADP OPERATIONS	1
ACCOUNTING MANUAL	5
CASH CONTROL	5
INVENTORY MANAGEMENT	6
Opportunity to improve physical inventory at the Indian Craft Shop	7
Need for control over receiving reports	7
Need for additional controls over inventories	8
FIXED ASSETS	9
Fixed assets at local units	9
Fixed assets at nonlocal units	10
PAYROLL	12
Need for the personnel section to initiate and review all payroll master file changes	12
Need for more timely updating of the master payroll file for new employees	13
Need for written check authorization of manually prepared payroll checks	14
Need to adjust final pay checks of employees with negative leave balances at termination	15
Need to establish policy for granting of unearned leave	17
JOURNAL VOUCHER REGISTER ENTRIES	18
OVERHEAD ALLOCATION	18

## ADP OPERATIONS

Our audit effort included a review of aspects of the ADP operations which, as you know, are in the process of change. We believe that the following matters require immediate action even during this change.

### 1. Need for system development planning and control

A written plan for system development planning and control has not been prepared even though system development efforts are currently in progress for every system except payroll. The absence of such a written plan can lead to projects with unclear objectives, ill-defined responsibilities and end products which satisfy no one.

A well-developed plan should include, as a minimum:

1. Objectives,
2. Manpower requirements,
3. Personnel responsible for system development, programing, testing and data conversion, and
4. Estimated completion dates for each segment of development.

The Vice President/Treasurer informed us that, while a plan would have been useful in development efforts, it was not prepared because of lack of staff. Considering the increased possibility for unsatisfactory results on a major project without formal planning, we believe that sufficient staff should be assigned in future efforts to develop a plan for system development planning and control.

### 2. Need for a separation of computer operation and programming functions

Proper internal control requires that computer operations and programming functions be separate and distinct. This separation prevents the undesirable situation in which operations personnel can implement unauthorized revisions without prior approval and thorough checking. The concentration of these responsibilities exposes a system to manipulation and fraud.

We found that the computer operation and programming functions are not adequately separated at GSI. Even though

a programmer is capable of programming in assembly language, the computer operations supervisor is still modifying the production programs written in assembly language. The Director of EDP agreed that separation of duties would strengthen internal controls, but stated lack of staff had prevented this. When programs are converted to COBOL (by the beginning of CY 76), the computer operations supervisor will not perform any program modifications.

We suggest that procedures be established which prohibit computer operations personnel from writing or modifying programs either during or after the conversion to COBOL, and which also prohibit the operation of the computer by programming personnel.

### 3. Need for improved control over computer program changes

The Director of EDP prepares system maintenance forms (work requests) for program modifications based on written or oral requests from either the Comptroller or the Vice President/Treasurer. A computer programmer prepares program changes based on the work request and oral instruction. Modification test results are not documented nor are all modifications or test results reviewed and approved by supervisory personnel.

Control over computer program changes is essential to ensure the effectiveness of internal control over data processing operations. Without proper review, unauthorized or inappropriate changes can be made. In addition, a review of program testing is essential to ensure the adequacy of modification testing. Without adequate testing, data may be destroyed and/or incorrect results obtained, resulting in loss of time and money.

The Vice President/Treasurer stated requests for modifications are now being made in writing and agreed that they should be completely tested and reviewed. He stated that they had been restricted from doing this by lack of staff.

We suggest that procedures be established and resources provided to ensure that (1) program changes are reviewed and approved in writing by supervisory personnel, (2) computer program changes are tested and approved for production by an acceptance testing team, and (3) computer program test results are documented.

4. Need for improved control over data files, computer programs, and associated documentation.

The data files for all applications and the computer programs and associated documentation for all applications except payroll are stored in the computer room accessible to computer operators.

Data files should be accounted for in a systematic manner so that the status of each is known at all times. A data file librarian should provide production data files to computer operators in accordance with a computer operating schedule. A data file library ensures that the computer operators have access only to the computer files needed in the current operations and helps prevent unauthorized changes to the files.

Access to computer source program listings and related documentation should also be restricted--preferably under lock and key outside the computer operations room. The computer operators should not have access to program documentation which would provide detailed information on how the programs operate and could be used to manipulate the programs.

The Vice President/Treasurer stated that, while a librarian would help increase controls over data files and might lessen the possibility of processing the wrong file, GSI's operations were too small to make a librarian function practical. He stated that source program listings and related documentation would be removed from the computer room as they are converted to COBOL.

We believe that the need for proper controls require that GSI provide resources to:

1. Assign an employee responsibility for custody of data files.
2. Restrict access to data files for use by computer operators in accordance with a processing schedule, and
3. Restrict access to source programs, related listings, and documentation to programmers responsible for their maintenance both before and after conversion to COBOL.

## 5. Need for predetermined control totals

Predetermined control totals are an effective method of controlling the number and dollar value of records processed by computers and the accuracy of the processing itself. The control totals are used to detect the loss or duplication of data, and are developed through the addition of specific data elements taken from each record processed. The comparison of the predetermined control totals with totals produced in computer processing is an effective method for detecting errors.

We noted several instances, in addition to the manual check forms discussed in the payroll section of this summary, where control totals could be implemented to provide greater assurance of processing accuracy. These areas, detailed below, were discussed with the Vice President/Treasurer who agreed with our suggestions and stated he would consider implementation.

Payroll processing--Predetermined control totals are not established for use in payroll processing. In January 1975, however, the Vice President/Treasurer requested the Director of EDP to establish control totals over regular hours, vacation hours, and overtime hours by units and to use the totals for balancing during processing.

Predetermined control totals over regular hours, vacation hours, and overtime hours by unit will improve the control over payroll processing. In addition, we believe that predetermined control totals should be established over pay rate to insure the accurate processing of pay rate information.

Inventory transfers--A two-part form (stub and sheet), Form 790, is used for recording inventory transfers. Commissary personnel submit the stub portion of the form to the inventory control section, indicating the type and quantity of items transferred to the units. Unit personnel submit the sheet portion of the form to the inventory control section indicating the type and quantity of items received. The inventory control section submits the stub portion for data processing but does not establish controls over the documents submitted. Although the stub and sheet portions of the form are compared, neither is compared to the computer report listing. Thus, in the current inventory system there is no control over the accuracy and reliability of the inventory transfer data being processed.

We recommend that predetermined control totals be established for inventory transfers to control the data movement and ensure the accuracy and reliability of processing.

#### ACCOUNTING MANUAL

Our May 1974 management letter included a suggestion that GSI document its accounting system in an organized manual of instructions. During this year's audit we were pleased to see that work has begun on the manual and suggest that you continue to place high priority on its development.

In regard to this effort, we would suggest that you consider including a classified chart of accounts in the manual and consider exploring the possibility of reducing the number of accounts used.

During this and previous years' audits, we experienced some difficulty in working with the accounts. As of December 1974, GSI's accounting system included over 500 accounts, and some of these accounts were inconsistently classified. For example, some expense accounts are assigned account numbers in the 500-000 series, while similar accounts are assigned numbers in the 700-000 series. Some accounts are quite specific and have very little activity during the year. While we realize management's desire for the amount of detail now given in GSI's accounts, the number of accounts and the inconsistencies cause confusion not only for us during our audits, but also for GSI personnel during the normal course of operations.

The Comptroller agreed that a reclassification of the accounts and analysis of each account to determine which ones, if any, could be eliminated or combined would improve control and make the accounting system more efficient. Therefore, in connection with preparation of the accounting manual, we suggest that a review of the accounts be made with a view toward reclassifying and possibly reducing the number of accounts used.

#### CASH CONTROL

To achieve maximum control over cash, bank accounts should be periodically reconciled with accounting records. While performing this year's audit, we noted that a reconciliation had not been performed for one bank account



(Payroll Account--Bank of America) since February 1974 and that another account (Working Change Fund--American Security and Trust Company) was not reconciled as of December 31, 1974, until 3 months after yearend.

The manager of the payroll section informed us that before our audit the last attempted reconciliation of the payroll account was in February 1974. During our audit, reconciliations were performed for the months of February, March, April, and May 1974, but not for the following months, nor was a reconciliation performed as of December 31, 1974. Our examination of this account showed that it was understated on GSI's records by approximately \$38,000 as of December 31, 1974. The error originated with a double reimbursement to the account in May. Instead of withholding the amount of the duplicate reimbursement from a subsequent payment when the error was discovered in August, an accounts receivable from Bank of America was established for the amount of the overpayment. Because this remained on GSI's records through December 31, 1974, it was necessary to adjust the yearend cash and accounts receivable balances to reflect the true balances in these accounts. We believe that if a periodic reconciliation of this account had been performed throughout the year this error would have been discovered earlier, corrective action taken, and the cash put to productive use.

A yearend reconciliation was not performed for the Working Change Fund until March 1975, after the books had been closed and the final statements had been prepared.

The Comptroller advised us that these reconciliations were not performed because of the confusion resulting from the changing of accounting personnel and the realignment of the duties and responsibilities of the individuals in the accounting department. He agreed that periodic and yearend reconciliations should be performed and stated that actions have been taken to insure that these are done in the future.

#### INVENTORY MANAGEMENT

In our May 1974 management letter we pointed out the need for a well-planned and coordinated inventory. We noted this year that the taking of the yearend physical inventory at the Commissary, Indian Craft Shop, and the

Maintenance Shop improved over last year primarily because of the use of written inventory instructions. Also, at the Commissary and the Indian Craft Shop, labels were used to mark items thus giving assurance that every item was counted. Although the items at the Maintenance Shop were pre-counted, and this count accepted by accounting personnel, some of the larger dollar items were test counted, which represents an improvement over prior years' inventories. Additional actions which we feel would improve inventory management are discussed below.

#### OPPORTUNITY TO IMPROVE PHYSICAL INVENTORY AT THE INDIAN CRAFT SHOP

During this year, as in prior years, the inventory at the Indian Craft Shop was pre-counted and the amount recorded on slips of paper and placed with the items counted before the actual inventory was taken. To perform this step it was necessary for the Shop to close an additional 2 days for the 1974 physical inventory and an additional 3 days for the 1973 inventory. Because of the nature of the yearend physical inventory, i.e., each item is recounted, we feel there is no useful purpose served by pre-counting the inventory. It appears that the only preparation needed on the part of the Indian Craft Shop employees is to group like items together. This would require considerably less time than actually pre-counting the inventory, thus providing better utilization of GSI employees and allowing the Indian Craft Shop to remain open an additional 1 or 2 days. The Comptroller agreed with our position and we suggest that appropriate written procedures be prepared before the next inventory.

#### NEED FOR CONTROL OVER RECEIVING REPORTS

While observing the taking of the yearend physical inventory at the Commissary, we noted that receiving reports are not used in sequential order, nor is an accounting made of all receiving reports. Without a proper accounting of all receiving reports the possibility exists that they could be lost, destroyed, etc., which could result in the failure to record, or the improper recording of inventory and liabilities on GSI's records. Since a yearend physical inventory is taken at the Commissary and the records adjusted to reflect the actual count, any unrecorded inventory items will be reflected

in the yearend balance through an adjustment increasing the inventory and decreasing the expense accounts. However, unless a second entry is made to set up the accounts payable for the unrecorded receiving reports by increasing expenses and accounts payable, both these accounts will be understated.

Because of the lack of control over receiving reports, we expanded our audit work to identify unrecorded liabilities at yearend. We found approximately \$5,500 of inventories that were received by GSI prior to December 31, 1974, not recorded at yearend. As a result of the physical inventory and the adjustment to reflect the actual count on the records, this amount was included in the December 31, 1974, inventory balance. However, an accounts payable was not set up for this amount because the accounting department did not process the receiving report before the books were closed. Therefore, both expenses and accounts payable were understated. At the beginning of 1975 when the receiving tickets for these items were processed an entry increasing both the inventory and the accounts payable was made, thus overstating the inventory account during 1975. At our suggestion an adjusting entry will be made to correct this error.

We believe that situations like the above could be eliminated if proper control were maintained over receiving reports. The Comptroller agreed that all receiving reports should be accounted for and that they should be used in numerical order.

We suggest that the Commissary use receiving reports in numerical order, that all receiving reports (both used and voided) be accounted for, and that a cutoff number for receiving reports be determined at yearend so that all items received prior to the cutoff are recorded before closing the books.

#### NEED FOR ADDITIONAL CONTROLS OVER INVENTORIES

Our May 1974 management letter included a suggestion that GSI establish procedures for the independent verification of inventories at local as well as nonlocal units. Through calendar year 1974, procedures were not established for the independent verification of inventories at all local and nonlocal units, except for the

Commissary, Indian Craft Shop, the Maintenance Shop and a few park units in the D.C. area.

In January 1975, a new position for one full-time employee was established with responsibility for performing unannounced verifications of inventories at local units. This individual advised us that he has visited the Commissary and several local units since January. The Comptroller stated that the verification activity has not yet been fully developed because the employee must first obtain a thorough understanding of the inventory process (i.e., paper flow and physical work) at both the Commissary and the local units. He stated that after this understanding is obtained, spot verifications of the inventory at local units will begin. The Comptroller also informed us that no definite plans have been made for this individual or an outside source to perform physical inventories at nonlocal units.

Because the inventories at nonlocal units represent over 5 percent of total assets, we again suggest that management establish procedures for the independent verification of inventories at these units.

#### FIXED ASSETS

Our 1974 management letter discussed the importance of performing periodic physical inventories of fixed assets to verify the existence of such assets. Since GSI was not performing systematic physical inventories, we suggested that procedures be established for the periodic inventorying of these assets and for adjusting accounting records for any discrepancies. Although progress has been made in this area, we believe that additional improvements are needed.

#### FIXED ASSETS AT LOCAL UNITS

Although systematic fixed asset inventories were performed at some local units during 1974, few records were maintained to show the result of these inventories and no written guidelines exist for the taking of these inventories.

The Director of General Services informed us that in 1974, GSI established a "rule of thumb" that the operating equipment at 25 percent of the units in the D.C. metropolitan area would be inventoried each year. During 1974

GSI inventoried 21 percent of the units in the D.C. area, which accounted for approximately 17 percent of the dollar value of the equipment located in this area and about 9 percent of GSI's total operating equipment. We attempted to review the working papers prepared during these inventories but were informed that except for a list of discrepancies, they had been destroyed. Since working papers were not available it was necessary for us to expand our audit work to satisfy ourselves as to the fairness of the fixed asset account. The Director of General Services agreed that working papers of physical inventories should be maintained and stated that in the future this would be done.

Because of the importance of fixed assets we suggest that management insure (1) that working papers are maintained as a record of inventories taken and to support resulting changes to the accounts and (2) that written guidelines are established for the taking of the inventories.

#### FIXED ASSETS AT NONLOCAL UNITS

In 1972 GSI purchased from Amfac/Fred Harvey, Inc. fixed concession assets at Sequoia/Kings Canyon National Park and Mt. Rainier National Park for Fred Harvey's book value plus \$225,000. These assets were capitalized in GSI's accounts at Fred Harvey's cost plus \$225,000 and Fred Harvey's depreciation was added to GSI's accumulated depreciation. As a result, GSI's fixed assets (equipment and leasehold improvements) and accumulated depreciation accounts are overstated by the amount of accumulated depreciation carried from Fred Harvey's records. The \$225,000 in excess of the book value of the assets acquired was placed in Sequoia's leasehold improvement account. Depreciation has been charged on the assets since purchase.

Although the ultimate effect of these entries resulted in a net asset increase equal to GSI's purchase price, it is not in conformity with generally accepted accounting principles. The American Institute of Certified Public Accountants Accounting Principles Board (APB) Opinion No. 16, requires that assets acquired be recorded at cost. When assets are acquired in groups, the total cost should be allocated to each individual asset on the basis of its fair value at date of acquisition. If cost exceeds fair value, assets are recorded at fair value and the excess cost is recorded as goodwill. If

fair value exceeds cost, the individual asset valuations should be proportionately reduced so that their total does not exceed cost.

A physical inventory of the assets at Sequoia and Mt. Rainier was not taken at the time the assets were acquired in 1972, nor has a complete physical inventory been taken since the purchase. GSI used Fred Harvey's property records as a basis for determining what assets existed at Sequoia and Mt. Rainier at the time of purchase but a spot check by the unit managers of these two locations in 1972 revealed that many of the assets on Fred Harvey's records could not be identified. In addition, GSI took a partial inventory at Sequoia during 1973. GSI's records were not adjusted for this inventory because fair value was not ascertained and only about 20 percent of the items counted could be traced to Fred Harvey's records.

As stated in your letter of March 11, 1975, an inventory and appraisal of value and useful life of assets at Sequoia and Mt. Rainier is being planned this year. Fred Harvey's asset cost plus \$225,000 and depreciation will then be removed from GSI's accounts and the fixed assets recorded in accordance with APB Opinion 16. You stated that appraisal value will be reduced on a pro rata basis to no more than cost of the assets to GSI should the appraisal value exceed cost and should appraisal value be less than cost, assets will be recorded at 1972 estimated value and excess cost charged to an intangible account and amortized. An appropriate rate of depreciation will be established for the assets based on the remaining term of the lease or life of the asset, whichever is shorter.

Because the book value of the assets at Sequoia and Mt. Rainier represents approximately 19 percent of the book value of the fixed asset accounts and 8 percent of total assets, we suggest GSI place high priority on inventorying the assets and establishing accountability for them. We also request that you inform us of your schedule well in advance so that a GAO representative can observe the inventories.

## PAYROLL

### NEED FOR THE PERSONNEL SECTION TO INITIATE AND REVIEW ALL PAYROLL MASTER FILE CHANGES

Our 1974 management letter contained several suggestions for the improvement of GSI payroll activities. This year we again tested the propriety of the payroll and related expenses by selecting at random the pay of 30 individuals from the pay period ending November 15, 1974. The results of our test indicated that the deficiencies we noted last year generally had been or were in the process of being corrected. One exception noted involved Federal income tax withholdings.

During last year's audit, we noted that in several instances withholding certificates on file for Federal income tax deductions did not agree with actual deductions being made. Our current efforts disclosed that this is a continuing problem. For 6 of the 30 employees we examined, the marital status on the payroll master file did not agree with that shown on the certificates, resulting in incorrect withholdings. Since one of the employees had a certificate on file that was dated after the November 15 payroll, we tested the December 23, 1974, payroll to determine if the withholding on this individual was updated. We found that it had not been changed. Thus, the withholdings for 20 percent of our sample did not agree with certificates on file.

The personnel department forwards certificates received to the data processing department for entry into the computer system. The data processing department enters the information and produces a file maintenance listing which is returned, along with the certificates, to the personnel department. The personnel department verifies the information on the file maintenance listing with the certificates. Based on discussions with officials in the personnel and data processing departments, it appears that the errors resulted during processing and went undetected by the personnel department.

In addition, the payroll section prepares a Payroll-Personnel Voluntary Deduction Form (Form 996) to record tax

levies, garnishments, and Fontana employees' hospitalization deductions. The payroll department batches the forms biweekly and sends them to data processing. Data processing updates the payroll master file with this information and produces a report listing the changes made to the file. Although this report is distributed to the payroll department, neither predetermined controls nor output review are used to assure the accuracy of the master file changes.

Permitting the payroll department to originate changes to the payroll master file weakens controls provided by the separation of duties between the personnel and payroll departments. In addition, 100 percent review of master file changes is essential because master file data has a lasting impact on the reliability of the payroll. Since changes submitted by payroll clerks (tax levies, garnishments, Fontana hospitalization) are not reviewed for accuracy or propriety, an improper or inaccurate update of a payroll record could be made.

We recommend that (1) the personnel department be made responsible for originating all payroll master file changes, and (2) the personnel department compare all master file changes to the original change documents.

#### NEED FOR MORE TIMELY UPDATING OF THE MASTER PAYROLL FILE FOR NEW EMPLOYEES

When an employee is hired, a Notice of Personnel Action Form (Form 850) is completed by either the personnel section or the unit manager. The personnel section is responsible for collecting all personnel action forms and submitting the forms to data processing by noon of the Friday before the end of the pay period. Data processing then updates the master file with the information on the forms.

If a time card is submitted for an employee for whom a master file has not been created, an edit routine will generate a report indicating the problem. This report is sent to the payroll department which will then prepare a manual check for the employee.

During January 1975, 115 employees were hired. Twenty of these employees were paid with a manual check because their master file had not been created before



their first time card had been submitted; 5 of the 20 employees were paid with a manual check for more than one pay period for the same reason.

The manual preparation of payroll checks increases the cost of processing the payroll, the chance for error, and the potential for improper manipulation. The latter is particularly critical since the procedures for manually preparing payroll checks do not provide adequate internal control, as discussed below.

We suggest that the personnel department investigate the causes for delays in processing additions to the master file for new employees and take steps to expedite this processing if possible.

#### NEED FOR WRITTEN AUTHORIZATION OF MANUALLY PREPARED PAYROLL CHECKS

Payroll checks are prepared manually when (1) a unit manager requests that a terminated employee be paid before the next payday, (2) a record has not been established on the payroll master file, (3) the master payroll file is incorrect, or (4) payroll adjustments are required. The personnel section and the unit managers authorize, often orally, the payroll section to prepare a manual check form.

Based on such authorization, the payroll clerk prepares a form requesting a manually prepared payroll check (manual check form), files any written authorization for payment, and sends the manual check form to the cashier for payment. The cashier prepares a payroll check from the manual check form.

Biweekly, the payroll clerk batches the manual check forms and sends them to data processing. Predetermined batch control totals are not established on the manually prepared check forms. The payroll section supervisor reviews a report listing all manually prepared check forms rejected during processing, but does not review forms which are not rejected.

Payroll transactions should be adequately supported by authorized documentation in writing to prevent duplicate, incorrect, or fraudulent payments. Source documents, such as pay adjustment authorizations, supporting the manual

preparation of payroll checks should be reviewed and approved by the payroll supervisor. The cashier should examine the manual check form for the payroll supervisor's approval before preparing the check.

Predetermined totals, not now used, should be established over the manually prepared check forms sent to data processing to preclude the loss or duplication of data.

We believe that procedures should be established which require that (1) proper authorization documentation be prepared outside the payroll section, (2) payroll check forms, including the authorization documentation, be reviewed and approved by the payroll supervisor, (3) payroll check forms be reviewed for the payroll supervisor's approval by the cashier before preparing a check, and (4) predetermined control totals be established over the manual check forms sent to the EDP department and be reconciled with totals produced during computer processing. The Vice President/Treasurer agreed with our suggestions and stated he would consider implementation.

NEED TO ADJUST FINAL PAY CHECKS  
OF EMPLOYEES WITH NEGATIVE  
LEAVE BALANCES AT TERMINATION

Current payroll procedures do not appear adequate to protect the Corporation against losses resulting from the termination of employees who have negative annual leave balances at the time of termination. Because of GSI's leave policy and the high annual employee turnover (98 percent for cafeteria workers) we suggest that management give this matter immediate attention.

To determine if employees' final pay checks were being adjusted for negative annual leave balances (leave used in excess of amounts earned) at the time of termination, we arbitrarily selected 8 employees whose employment with GSI was terminated during the last 6 months of 1974 and who had a negative leave balance at the time of termination.

We found that the final pay check for only one of these employees was adjusted for the negative leave balance. One of the employees had been erroneously listed on the termination run and was still employed

by GSI. The final pay checks of the remaining six employees were not adjusted for the negative annual leave balance and resulted in overpayments totaling \$540. Each of the six employees whose final pay check was not adjusted owed GSI an average of 35 hours of annual leave.

We observed that there is confusion concerning the proper procedures to be followed when the employment of a GSI employee is terminated. With the assistance of payroll and personnel department officials the only written procedures we found on this subject were dated in 1958. These procedures state that:

"all hourly paid employees and all annual salaried employees below the grade of supervisor or department head whose services are terminated for any reason whatsoever, will receive any monies due them only through, or by the approval of, the Office of the Supervisor, Employee Relations [currently the personnel department]....when the employment of any person is terminated, either by resignation, discharge, or lay-off, he will be advised that he must make arrangements for any monies due him with the [personnel department]... The employee will not be given his final pay check or be paid off in petty cash without the prior approval of the [personnel department] which is also responsible for checking with the payroll department to determine if the employee is currently charged with unearned leave or other debts to the Corporation"

These procedures are not being followed. Currently, the Accrued Benefits Journal is the only immediately available report at the central office concerning the annual leave balances of employees. This run is maintained in the personnel department although all of the information included is either generated by or channeled through the payroll department. According to an official of the personnel department, in many cases the payroll department is contacted directly by the unit managers when an employee quits or is fired and a final check written prior to the personnel department being notified of the termination. The official also stated that the personnel department would notify the payroll department of negative leave balances only if that department requested the information.

We were informed by a payroll department official that the final pay check of an employee with negative leave balances would not be adjusted unless notification of such leave is given to payroll by the unit manager or the personnel department.

We do not feel that it is the responsibility of the unit manager to notify the payroll department of negative leave balances of terminated employees. As stated in the 1958 written procedures, the personnel department should be responsible for assembling all of the pertinent information when an employee is terminated and notifying the payroll department of such information before a final check is issued. The Comptroller agreed and stated he believes the unit manager should notify the personnel department when an employee is terminated and the personnel department should notify the payroll department of any negative leave balances before a check is issued. This procedure would prevent the payroll department from issuing manual checks without first receiving the proper information and notification from the personnel department.

Although we did not attempt to project the full effect of this weakness in the internal controls, we do feel this problem could be significant considering the high turnover of GSI employees and GSI's leave policy whereby employees are allowed to use unearned leave. We therefore recommend that management (1) establish a procedure that would require all employees to be processed through the personnel department when their employment is terminated, and (2) establish definite guidelines to prevent an employee from receiving a final pay check until the amount has been adjusted for any leave the employee might owe GSI.

#### NEED TO ESTABLISH POLICY FOR GRANTING OF UNEARNED LEAVE

The Director of Personnel advised us that although no written procedures exist, it is GSI's policy to allow employees to use unearned leave but only up to the amount they will accrue during the calendar year. We found that this policy is not being followed. One employee in our payroll sample had used 156 hours of annual leave although he was only entitled to 120 hours for the entire year. A review of the Accrued Benefits Journal for the last period in calendar year 1974 revealed many employees with negative leave balances.

An April 1972 change in GSI's leave policy precludes employees from carrying over annual leave into the next year. In view of this policy and the fact that employees are being allowed to use leave in excess of what they will earn in a given year, we inquired into the disposition of negative leave balances at the end of the year.

We were informed by a payroll official that no adjustments are made to employee's paychecks at the end of the year for negative leave. To determine whether the negative leave balances are carried forward into the next year, we selected at random 10 employees who had negative leave balances at the end of 1974. None of the negative leave balances had been carried forward. The Vice President/Treasurer informed us that he is aware this situation exists and stated that action would be taken to correct the problem.

We suggest that management give high priority to establishing a written leave policy and the controls needed to ensure compliance with the policy.

#### JOURNAL VOUCHER REGISTER ENTRIES

An adequate system of internal control should include procedures for regular review and written approval of all Journal Voucher Register entries by a responsible official. Our review of the Journal Voucher Register (Book 8) and supporting documentation indicated that such procedures are not currently being followed. Because the Journal Voucher Register is a book of original entry used to record all of the uncommon transactions for which special journals have not been provided, we suggest that all Book 8 transactions that are of a nonrecurring nature be approved by a responsible employee other than the employee preparing them.

The Comptroller agreed with our suggestion and in March 1975 issued a memorandum to all accounting personnel requiring that all manually prepared journal vouchers be approved by him.

#### OVERHEAD ALLOCATION

As you know the Corporation is currently considering a change in the overhead allocation rate for central office expenses to the nonlocal units (Fontana, Sequoia, and Mt. Rainier). At your request, we reviewed the

computation of the proposed overhead rate change and the supporting documentation for these computations. Our review was concerned primarily with the overall method involved in arriving at the application rate and did not include a detailed verification of the accuracy of the computations.

Currently, GSI is using a two-tier system of allocating the expenses of the central office to the various units. The overhead is applied to the nonlocal units at a rate equal to 2-1/2 percent of each unit's revenue. The remainder of the overhead is divided proportionately among the local units on the basis of revenue.

The proposed new allocation method is essentially the same as the one currently used, except that under the new method the overhead rate would be different for each nonlocal unit, i.e., Fontana--2.46 percent; Sequoia--1.5 percent; and Mt. Rainier--2.12 percent. In computing the proposed change, GSI identified the portion of time each central office department spends on matters relating to each nonlocal unit. This was converted to dollars by multiplying the time by central office 1974 budget expense figures. An application rate was arrived at by comparing the dollar estimate above to the forecasted revenue of each nonlocal unit. Thus, the amount of overhead to be applied to the nonlocal units would vary with the revenue of these units rather than with the percentage of time spent by central office employees on these units. This could result in an unfair portion of the central office expense being applied to one or all of the nonlocal units and in turn to the local units. Discussions with the Comptroller and the Budget Director indicate that the time spent by the central office on the nonlocal units will not vary directly with the revenue of those units.

By applying overhead to nonlocal units on the basis of percentage of sales, the amount applied to a particular unit would double if the revenues of that unit doubled, although there would probably be very little change in the time devoted to that unit by the central office.

Since GSI has already determined data needed to estimate the percentage of central office expense applicable to each nonlocal unit, we believe that a more equitable

distribution of overhead to these units would be to apply this percentage to the actual central office expense. This method would cause the overhead applied to nonlocal units to vary with the overhead expense rather than the revenue of the units. Both the Comptroller and the Budget Director agreed that this would be a more accurate distribution of overhead. In order for this, or any other method to remain valid, it would be necessary to review the percentage periodically and make any necessary adjustments.

Finally, the proposed changes as presented to us were based on budget figures for 1974. We suggest that the proposal be revised by substituting actual 1974 amounts.

As of May 14, 1973, 16 items of travel expenses totaling \$3,724 were due the Office of Education for calendar years 1969 through 1972 from educational institutions and other organizations for reimbursable travel expenses of Office employees.

In a test of travel advances to employees as of May 11, 1973, we noted that 15 advances, totaling \$4,660, had been outstanding for more than 3 months. Of this amount, \$1,180 was advanced in calendar year 1972. HEW regulations require outstanding travel advances which have been outstanding for 30 days or more be recovered.

Over \$50,000 of accounts receivable recorded in fiscal years 1971 and 1972 were still outstanding as of May 31, 1973, including about \$42,000 due from the Environmental Protection Agency and about \$5,000 due from the Office of the Secretary, HEW. In addition, there were about \$6,000 of emergency salary advances outstanding for more than 3 months, with \$3,500 of these advances outstanding for more than a year.

#### Receivables not recorded

The principles, standards, and related requirements pertaining to controls over collections prescribed by the Comptroller General require that amounts receivable shall be recorded accurately and promptly on completion of the acts which entitle an agency to collect amounts owed to it (2 GAO 12.4). The HEW Accounting Manual provides for the recording of all amounts due from Federal and non-Federal sources in the accounting records as accounts receivable.

At the Food and Drug Administration headquarters, bills to transportation carriers for refunds on unused transportation tickets amounting to about \$15,000 were not recorded in the accounts receivable accounts as of May 31, 1973, and sales of publications and equipment of about \$800 in fiscal year 1973 were not recorded as accounts receivable prior to collection of the sales proceeds. At Region III, refunds of about \$4,400 collected in fiscal year 1973 from carriers for unused transportation tickets were not recorded as accounts receivable before the refunds were collected.



COLLECTIONS NOT PROMPTLY DEPOSITED

The principles, standards, and related requirements concerning control over collections prescribed by the Comptroller General require that all collections received by agencies shall, insofar as possible, be deposited daily (7 GAO 12.2). The HEW Accounting Manual provides that all cash collections should be placed under accounting control immediately upon receipt and deposited intact daily, insofar as possible.

We examined 58 fiscal year 1973 deposits of cash receipts, totaling \$126,170 at headquarters' offices. Thirty-eight deposits totaling \$110,891 were made from 4 to 23 days after the receipts were received, as shown below.

<u>Deposit delay (days)</u>	<u>Office of Education</u>		<u>Social and Rehabilitation Service</u>	
	<u>Number of items</u>	<u>Amount</u>	<u>Number of items</u>	<u>Amount</u>
4-9	9	\$12,961	2	\$ 7,230
10-15	8	7,079	2	1,320
16-23	<u>6</u>	<u>21,117</u>	<u>1</u>	<u>1,526</u>
TOTAL	<u>23</u>	<u>\$41,157</u>	<u>5</u>	<u>\$10,076</u>

<u>Deposit delay (days)</u>	<u>Food and Drug Administration</u>		<u>Total</u>	
	<u>Number of items</u>	<u>Amount</u>	<u>Number of items</u>	<u>Amount</u>
4-9	4	\$54,269	15	\$ 74,460
10-15	2	1,612	12	10,011
16-23	<u>4</u>	<u>3,777</u>	<u>11</u>	<u>26,420</u>
TOTAL	<u>10</u>	<u>\$59,658</u>	<u>38</u>	<u>\$110,891</u>

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GENERAL LEDGER ACCOUNT NOT RECONCILED  
WITH SUBSIDIARY RECORDS

7 GAO 25.6 requires periodic reconciliation of general ledger control accounts for outstanding travel advances with records of individual outstanding advances. The HEW Voucher Examiners Manual requires monthly reconciliations of the general ledger control account for travel advances with balances shown by subsidiary records.

At Region III, the general ledger control account for travel advances and emergency salary advances was not reconciled with subsidiary records at the end of fiscal year 1973.

CONCLUSIONS

Responsible managers advanced many reasons for the existence of the practices outlined, but in most cases cited a lack of resources or of awareness of the requirement or the condition. They generally promised to correct deficiencies brought to their attention, except where lack of staff resources prevented such action.

In our opinion, financial managers should be aware of the Comptroller General's requirements and of existing practices in their activities, and staff adequate to meet the requirements should be provided.

RECOMMENDATION

Accordingly, we recommend that you and the heads of the constituent agencies concerned take necessary action relative to the controls over, and examination of, receipt and disbursement transactions to insure compliance with the accounting principles, standards, and related requirements prescribed in the GAO Policy and Procedures Manual for Guidance of Federal Agencies and HEW's implementing instructions.

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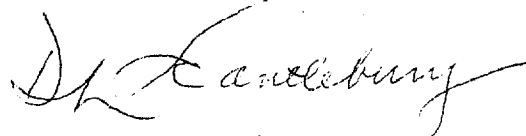
By letter dated March 5, 1975 (B-164031(1)), the Secretary of Health, Education and Welfare, was informed of significant problems existing in the financial management system of the Office of Education observed during our examination. We plan to review the actions taken to correct these problems at an appropriate time in the future.

B-164031(1)

In accordance with 8 GAO 13, the financial records of the Office of Education, Social and Rehabilitation Service, and Food and Drug Administration through fiscal year 1974 may be transferred to the Federal Records Center in accordance with the agency's records management program.

We would like to be advised of actions taken to correct the deficient practices discussed in this report.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "D. L. Scantlebury", written in dark ink.

D. L. Scantlebury  
Director